

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
of	:	
PHILIP MORRIS COMPANIES, INC.	:	DETERMINATION
	:	DTA NO. 810276
for Revision of a Determination or for Refund	:	
of Tax on Gains Derived from Certain Real	:	
Property Transfers under Article 31-B of	:	
the Tax Law.	:	

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Petitioner, Philip Morris Companies, Inc., 120 Park Avenue, New York, New York 10017, filed a petition for revision of a determination or for refund of tax on gains derived from certain real property transfers under Article 31-B of the Tax Law.

A hearing was held before Thomas C. Sacca, Administrative Law Judge, at the offices of the Division of Tax Appeals, Riverfront Professional Tower, 500 Federal Street, Troy, New York, on February 3, 1993 at 9:15 A.M. Petitioner submitted its brief on May 17, 1993. The Division of Taxation submitted its brief on October 15, 1993 and petitioner filed its reply brief on December 20, 1993. Petitioner appeared by Hunton & Williams (James W. Shea, Esq. and David A. Agosto, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Paul A. Lefebvre, Esq., of counsel).

ISSUES

I. Whether an appraisal commissioned by petitioner accurately reflected the fair market value of certain real property for purposes of the real property transfer gains tax.

II. Whether petitioner is entitled to a deduction for brokerage fees.

III. Whether petitioner is entitled to a step-up in original purchase price pursuant to 20 NYCRR former 590.49(c).

IV. Whether petitioner has established that penalties assessed for failure to timely file certain returns and failure to timely remit tax due should be abated.

FINDINGS OF FACT

Petitioner, Philip Morris Companies, Inc. ("Philip Morris"), is a corporation organized and existing under the laws of the Commonwealth of Virginia. Prior to its merger into Kraft, Inc. in 1988, General Foods Corporation ("General Foods") was a corporation organized and existing under the laws of the State of Delaware. Its corporate headquarters were located at 800 Westchester Avenue, Rye Brook, New York.

On November 2, 1985, petitioner completed the acquisition by purchase of all of the issued and outstanding shares of common stock of General Foods. Petitioner paid \$120.00 per share for approximately 47 million shares and options of General Foods stock, for a total purchase price of over \$5.6 billion. Petitioner offered testimony that during the four months prior to the announcement of its bid for the shares of General Foods, over 31 million shares of General Foods stock was traded, and the average price per share traded during that period was nearly \$80.00. In connection with the sale of its stock to petitioner, General Foods paid \$14,061,766.00 in fees to Goldman, Sachs & Co. ("Goldman") and Shearson Lehman Brothers, Inc. ("Shearson") (\$7,030,883.00 each) "[f]or services rendered pursuant to our letter agreement dated September 26, 1985" and "[f]or financial advisory services rendered to General Foods Corporation pursuant to our fee agreement of September 26, 1985", respectively, as indicated on invoices issued by Goldman and Shearson to General Foods. The letter and fee agreements of September 26, 1985 were not introduced into the record of this matter. Petitioner's Director of State and Local Taxes testified that the services paid for were advising General Foods during the merger and providing advice to General Foods as to whether the offer being made by petitioner was in the best interests of the General Food shareholders. In addition, he stated that the invoice amounts represented the fees for all services rendered in the merger. At the time of the purchase of its stock by petitioner, General Foods owned real property holdings throughout the United States, of which 12, including General Foods' corporate headquarters, were located in the State of New York.

In 1983, General Foods built its corporate headquarters on a parcel of land comprising approximately 55 acres located at 800 Westchester Avenue, Rye Brook, New York (the

"property") at a cost of approximately \$97 million. The headquarters is a nine-story structure containing a floor area of 1,063,000 square feet, of which 500,000 square feet make up the parking garage located on the lobby level and first and second floors. The building is considered a one-of-a-kind, signature type corporate headquarters. The building houses a dome-topped atrium which provides a panoramic view of the landscaped grounds and the pond (7 acres) situated on the Rye Brook property from several levels of the building.

Upon entering the building, one circles a fountain and passes the main lobby. The main lobby features mirrored walls and ceiling which reflect the lighting. Windows in the glass ceiling of the lobby provide a glittering view of the atrium above. Other features include an employee cafeteria seating 1,200, a service dining room, conference dining rooms, offices above the parking garage and in the atrium dome (for top executives), various shops, a fully-equipped fitness center, a soundproof studio for television productions, computer center and a state-of-the-art auditorium. The professional appraiser (Mr. Andrew Gyetvan, Jr.), who developed the valuation of the corporate headquarters for petitioner with regard to the real property transfer gains tax, testified that the headquarters building is a one-of-a-kind corporate headquarters built for a specific user to create a particular image.

Prior to the building being completed, the Town of Rye placed a market value on the Rye Brook property for real property tax purposes of \$44 million as of February 1983. The following year, the Town of Rye commissioned two appraisers to evaluate the property for real property tax purposes as of February 1984. The two appraisers developed a value of \$62,750,000.00.

The Town of Rye's increase in market value translated into an increase in the assessed value of the Rye Brook property of approximately \$2 million. General Foods then commissioned an appraisal of the Rye Brook property to support an appeal for a reduction in assessed value. The appraisal commissioned by General Foods concluded that the market value for the Rye Brook property as of February 1985 was \$65,000,000.00. The Town of Rye and General Foods reached a compromise value of \$63 million based on a combination of their

appraisals, resulting in a reduction of tax assessed.

On October 24, 1985, prior to the completion of the acquisition of General Foods, the Tax Manager of General Foods informed the Department of Taxation and Finance's Tax Compliance Division of the substance of the transaction and explained that the filing of gains tax returns would be delayed due to the complexities of the transaction. The letter requested an extension of time until December 31, 1985 to file the gains tax returns. By letter dated October 29, 1985, petitioner's Director of State and Local Taxes independently advised the Department of the transaction.

Having not received a reply, on November 6, 1985 General Foods sent a second request for extension to file a gains tax return. The Division of Taxation ("Division") responded on November 29, 1985 with its position regarding the filing of gains tax returns in the case of the acquisition of a controlling interest, namely that, in determining whether reasonable cause existed for failure to pay the gains tax, the Division will take into account the fact that it may not be possible to determine the consideration until sometime after the acquisition. In letters dated December 26, 1985, March 12, 1986, September 3, 1986 and December 12, 1986, General Foods requested extensions of time to file gains tax returns due to the continuing difficulty in accumulating the necessary information regarding the "original purchase price" and "consideration" received relating to the real estate held in New York State. The last letter requested an extension to March 31, 1987. The Division responded in a letter dated December 22, 1986 to General Foods that any future request for an extension of time to file the gains tax returns was unwarranted. The letter further stated that if the required forms were not filed by January 31, 1987, penalty and interest would be imposed from that date.

On February 9, 1987, General Foods informed the Division that appraisers were currently determining the market value of all the assets located throughout the United States and would not complete the determination of New York assets until August 1987. The letter also indicated that General Foods was aware that the Division did not grant extensions of time to file transfer tax returns. Subsequently, telephone calls from the Division to General Foods were made on

February 2, 1988, August 22, 1988, August 23, 1988, August 24, 1988, September 2, 1988, September 6, 1988, September 9, 1988, September 19, 1988, September 21, 1988, October 26, 1988 and October 28, 1988.

The Division sent a letter, dated January 11, 1989, requesting that General Foods provide the following documents relating to the New York property:

- a. Transferor Questionnaire, TP-580
- b. Transferee Questionnaire, TP-581
- c. Contract of Sale - Transferor's Original Acquisition
- d. Closing Statement - Transferor's Original Acquisition
- e. Contract of Sale - Proposed
- f. Copy of the executed broker agreement for proposed transaction

In response, General Foods advised on January 23, 1989 that it was accumulating the necessary data and forwarded a list of the real estate holdings in New York State, including the Rye Brook property. The Division replied on April 25, 1989, that before a final determination could be made, the following information should be submitted:

"- A copy of the agreement (with all statements) setting forth the terms of the transfer (e.g., contract of sale of real property, contract for sale of stock of a corporation or economic interest in a partnership or other entity).

"- The fair market value of the real property in New York State, on the date of transfer. Also, include the basis used to determine the fair market value."

In addition, the Division telephoned General Foods on January 17, 1989 and June 12, 1989.

On July 11, 1989, the Division sent a letter to General Foods accompanied by copies of letters sent and listing the telephone calls made by the Division to General Foods relating to the transaction at issue. The letter stated that although General Foods had indicated that the appraisals would be completed by August 1987, questionnaires from the transferor (General Foods) or transferee (petitioner) had not been received. The letter requested that the questionnaires be provided, that the consideration be substantiated by appraisals and that documentation for the original purchase price be provided.

Petitioner responded on August 22, 1989 by filing executed transferor and transferee

gains tax questionnaires relating to its acquisition of General Foods on October 28, 1985. Petitioner enclosed a check in the amount of \$2,630,066.00 in payment of the tax of \$1,862,284.00 and interest of \$767,782.00. Petitioner and General Foods calculated and set forth the taxable gain as follows:

Gross Consideration	\$ 75,451,681.00
Original Purchase Price	<u>(56,828,835.00)</u>
Gain subject to tax	\$ 18,622,846.00

In connection with the purchase by petitioner of all of the issued and outstanding stock of General Foods, an election was made pursuant to Section 338 of the Internal Revenue Code ("IRC") to treat the stock purchase as an acquisition of all of the assets of General Foods by petitioner. Accordingly, the assets were treated as having been sold by General Foods to petitioner at fair market value as of the acquisition date. In order to determine the fair market value of the assets transferred under the IRC § 338 election, the assets of General Foods, including the Rye Brook property, were valued as of the acquisition date (November 2, 1985) in accordance with Accounting Principles Board Opinion Number 16 ("APB No. 16").

Petitioner and General Foods retained Kenneth Leventhal & Company ("Leventhal") to perform the appraisals required with respect to the election made under IRC § 338. The purpose of the Leventhal valuations was "to estimate the fair market value of certain real property assets owned by General Foods . . . as of November 2, 1985 for purposes of basis allocation pursuant to the Section 338 election." The report defines "market value" as "the most probable price in terms of money which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller, each acting prudently, knowledgeably and assuming the price is not affected by undue stimulus". The report provides that certain conditions are implicit in the above definition, including the following:

"a. Buyer and seller are typically motivated

"b. Both parties are well informed or well advised, and each acting in what they consider their own best interest."

One of the contingent and limiting conditions contained in the Leventhal Report states that:

"This report is to be used only by Philip Morris or General Foods for the

purpose of estimating the value of the subject property for federal income tax basis allocation and accounting and financial reporting application of Accounting Principles Board Opinion #16, should not be used for any other purpose."

Leventhal employed only the cost approach in developing its valuation of \$113,335,700.00 for the Rye Brook property. The estimation is as follows:

	<u>Land</u>	<u>Sec. 1245</u>	<u>Sec. 1250</u>	<u>Total</u>
Land	\$11,962,500.00	\$ -	\$ -	\$ 11,962,500.00
Land Improvements	-	-	1,514,400.00	1,514,400.00
Building	-	-	95,384,700.00	95,384,700.00
Building Improvements	-	<u>4,474,100.00</u>	-	<u>4,474,100.00</u>
	\$11,962,500.00	\$4,474,100.00	\$96,899,100.00	\$113,335,700.00

This appraised value of \$113,355,700.00 was used by petitioner on its Federal returns to represent the value of the Rye Brook property. The appraiser who did the evaluation of the Rye Brook property for purposes of the gains tax filings, Mr. Gyetvan, testified that while the use of one valuation approach may be sufficient to satisfy the requirements of IRC § 338 and APB No. 16, a determination of market value for other purposes, including the gains tax, should be far more encompassing with development of all three approaches: cost, sales and income.

The copy of the Leventhal Report introduced into the record of this matter contained 5 of the 18 pages of the report, and also lacked three schedules, maps and site plans that are part of the original document. It was these 5 pages that upon which the appraiser based his evaluation.

Petitioner and General Foods hired Valuation Research Corporation ("Valuation") to conduct an appraisal of the Rye Brook property as of November 2, 1985 for purposes of the gains tax filings. In a letter dated August 14, 1989 to petitioner, Valuation stated that:

"The purpose of the appraisal was to determine the fair market value of the fee simple interest of the subject property as of November 2, 1985, in compliance with Article 31-B of the New York Tax Law, which imposes a tax on the gain realized from the transfer of real property . . . ."

The report further added that the definition of market value for the purposes of the gains tax conforms closely to the generally accepted definition of market value. The appraisal opinion of Valuation was based upon the definition of market value contained in the gains tax regulations.

Mr. Gyetvan, who developed the valuation of the Rye Brook property for Valuation, testified that he determined a value for the property using the cost approach, the income

approach and the sales comparison approach. For all three approaches, the land was valued at \$200,000.00 per acre for a total value of the 55-acre parcel of \$11,000,000.00.

The cost approach involved the following steps as employed by the appraiser:

1. Estimating the cost to reproduce (or replace) the basic improvements, new.
2. Estimating the dollar amount of accrued depreciation due to:
  - a. physical deterioration
  - b. functional obsolescence
  - c. external obsolescence
3. Deducting the total amount of accrued depreciation from cost new to derive the present depreciated cost of the basic improvements.
4. Adding the land value estimate to the depreciated cost of the improvements to arrive at a value indication by the Cost Approach.

The appraiser used the Marshall Valuation Service as a guide to develop a unit rate for the building improvements which included the office space, the garage and site improvements. The original cost of the building (\$97,000,000.00) was considered but not used. The section of the office tables and cost-per-square-foot tables from the Marshall Valuation Service were not introduced into the record of this matter nor could the appraiser remember which tables were used. The cost summary was as follows:

Corporate Headquarters (1,063,000.00 SF @ \$76.75) =	\$ 81,600,000.00
Site Improvements	5,400,000.00
Developer's Profit and Overhead (15%)	<u>13,050,000.00</u>
Total Reproduction Cost New	\$100,050,000.00

From this estimate is deducted the three types of depreciation that cause a loss in value: physical depreciation, functional obsolescence and external obsolescence. As the building was only two years old, the appraisers considered it new, without physical depreciation.

The second type of depreciation, functional obsolescence, which was defined as "an impairment of design resulting from a loss in functional utility, capacity, layout or efficiency" tends to have a negative impact on the value of a building. The report stated that such examples include the maintenance expense associated with the building's aluminum clad exterior surfaces, insufficient restroom facilities located in the general office area and the generally overbuilt



elaborate nature of the building. The report provided for an allowance of 10% for functional obsolescence.

The third type of depreciation and the second applied to the building at issue is external obsolescence, which involves external factors which negatively impact the value of the building. An example of external obsolescence as it related to this building was the size and unique nature of the building which would limit the number of potential users and, hence, make the marketing of the building difficult. Another external obsolescence factor, according to the appraiser, was the association of the building with General Foods. The appraiser testified that the building was built for a specific user to create an image, and, therefore, someone that goes in is going to have to rework the image. A 15% allowance was made for external obsolescence. The total accrued depreciation (25%) was subtracted from the reproduction cost (new) to arrive at total value of improvements which when added to land value resulted in total value of \$86,000,000.00.

The income approach is defined in the Valuation report as:

"a mathematical measure of what an investor would pay to acquire a property which can reasonably be expected to produce a certain level of net operating income over its remaining economic life; the higher the earnings, the higher the value."

Under the income approach, the appraiser examined comparable properties in the marketplace and developed a rent that the property would command. Due to the unique features and construction of the building, the appraiser's analysis was based on a single-user tenant situation.

The appraiser examined comparable leased properties in the Westchester County and Fairfield County areas with respect to rent level, location and amenities offered in determining a rental value of the building. He then determined a potential gross annual rent in the amount of \$10,234,000.00, after making adjustments based on differences between the comparable rentals and the building. This gross annual rent was adjusted to account for vacancy rates, collection loss and management fees, repairs and other expenses, resulting in a net operating income of \$7,919,828.00 with respect to the building. The net operating income was then converted into a property value by use of an overall capitalization rate of 9.75% resulting in a value of

\$81,000,000.00 for the Rye Brook property under the income approach.

The Valuation Report describes the sales comparison approach as follows:

"The Sales Comparison Approach is based upon an analysis of actual sales of other similar properties which are compared with the subject. Comparable sales represent the actions of typical buyers and sellers in the marketplace and their actions in the market will determine a price for the subject. When there is an adequate number of sales of truly similar properties with sufficient information for comparison, a range of values for the subject property can be developed."

The appraiser testified that for this approach he went into the market and identified sales of property that he felt were comparable to this property. Due to the nature of the property, he endeavored to identify properties in the immediate locale that were most similar. In addition, the appraiser went outside the immediate area to identify sales of corporate, quality headquarters throughout the country, and using a combination of both, through an adjustment process, came to an adjustment unit rate. Adjustments to the selling prices were necessary due to the variations in the comparable sales. Although the adjustments are listed in the report's summary, none of the adjustment percentages were placed in evidence. In this case, for the 563,000 square feet, the appraiser came to a value of land of \$150.00 per square foot. The value of the Rye Brook property under the sales comparison approach was \$84,500,000.00.<sup>1</sup>

The report concludes that the fair market value of the Rye Brook property for gains tax purposes as of November 2, 1985 was \$81,000,000.00.

Mr. Lloyd Looram, C.P.A. and state and local tax consultant, after reviewing data (referred to as "share movement" and "share transactions" occurring prior to the acquisition), supplied by the Director of State and Local Taxes for Philip Morris, testified that during the four months prior to the announcement of petitioner's bid for the shares of General Foods over 31 million shares of General Foods stock was traded, and the average price per share traded during that period was nearly \$80.00. Mr. Looram developed a document entitled "Adjusted Price and Volume Report" which was introduced into the record of this matter. The report lists

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<sup>1</sup>The largest comparable property was 44 acres, with the next being 10 acres. The age of the comparable properties ranged from 5-10 years. Two of the comparable properties are only listed in "good" condition, while the subject property was in "excellent" condition.

the daily volume, daily high, daily low and daily close of the stock of General Foods for the days beginning May 31, 1985 and ending September 30, 1985. Also introduced was a listing of the institutional holders of General Foods stock and the amount owned on June 14, August 2, September 30 and October 25, 1985.

On November 24, 1989, the Division issued to petitioner a notice of determination asserting real property gains tax due in the amount of \$2,451,756.69, including interest. The notice was based upon the Leventhal Report valuation of the Rye Brook property.

On February 20, 1990, petitioner timely filed a Request for Conciliation Conference. A conciliation conference was held on January 22, 1991 and the Conciliation Order, dated September 13, 1991, sustained the Division's notice of determination.

Petitioner filed a petition with the Division of Tax Appeals on December 11, 1991, and subsequently filed an amended petition on April 13, 1992. On April 27, 1992, the Division filed its Answer which assessed, for the first time, penalty on the transfer at issue.

#### CONCLUSIONS OF LAW

A. Tax Law § 1441 imposes a tax at the rate of 10% on gains derived from the transfer of real property within New York State. Section 1440.7 defines a "transfer of real property" to mean:

"the transfer . . . of any interest in real property by any method, including but not limited to sale . . . or acquisition of a controlling interest in any entity with an interest in real property."

Thus, the sale of all of the stock of General Foods to petitioner constituted a transfer of real property for gains tax purposes (see, Matter of Bredero Vast Goed N.V. v. Tax Commn. of the State of New York, 146 AD2d 155, 539 NYS2d 823, 825, appeal dismissed 74 NY2d 791, 545 NYS2d 105; Matter of Shareholders of Beekman Country Club, Tax Appeals Tribunal, April 16, 1992, confirmed \_\_\_ AD2d \_\_\_, 604 NYS2d 989). Tax Law § 1440(3) defines "gain" as "the difference between the consideration for the transfer of real property and the original purchase price of such property . . . ." The term "original purchase price" is defined as,

generally, the consideration paid or required to be paid by the transferor to acquire the interest in real property, plus the cost of certain improvements and customary expenses as set forth in the statute (Tax Law § 1440[5][a]). The threshold level at which this tax first applies is reached when the consideration for the property transferred equals or exceeds \$1,000,000.00 (Tax Law § 1443[1]).

B. The term "consideration is defined as "the price paid or required to be paid for real property or any interest therein . . ." (Tax Law § 1440[1][a]). Section 1440(1)(c) and (2) further provide that:

"In the case of a transfer of a controlling interest in an entity with an interest in real property, there shall be an apportionment of the fair market value of the interest in real property to the controlling interest for the purpose of ascertaining the consideration for the transfer of such controlling interest.

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"'Controlling interest' means (i) in the case of a corporation, either fifty percent or more of the total combined voting power of all classes of stock of such corporation, or fifty percent or more of the capital, profits or beneficial interest in such voting stock of such corporation . . . ."

20 NYCRR 590.47 provides in part as follows:

"Consideration

"(a) Question: Is the price paid for the ownership interest in an entity the consideration for a controlling interest used to calculate gain?

"Answer: Generally, no. Section 1440.1 of the Tax Law states that '. . . there shall be an apportionment of the fair market value of the interest in real property to the controlling interest to ascertain the consideration for the controlling interest'.

"Example: A corporation's only asset is a \$4 million fair market value piece of property. If 100% of the stock is purchased, the consideration is \$4 million (\$4,000,000.00 x 100%). If a 50% interest were acquired, only \$2 million consideration is used to calculate gain.

"(b) Question: How is fair market value determined?

"Answer: Generally, by appraisal. It is the amount a willing buyer would pay a willing seller for the real property . . . ."

C. The burden of proof is upon petitioner to establish that the fair market value of the Rye Brook property was \$81,000,000.00 as of November 2, 1985 (Matter of Kim Poy Lee v.

Tax Appeals Tribunal, \_\_\_AD2d\_\_\_, 610 NYS2d 331). The Tax Appeals Tribunal has held that the fair market value of real property is "the price at which a willing seller and a willing buyer will trade" (Matter of Shareholders of Beekman Country Club, *supra*, citing Matter of Bridgehampton Investors Corp., Tax Appeals Tribunal, August 11, 1988, quoting Black's Law Dictionary 717 [4th ed 2957]).

An appraisal of the Rye Brook property was performed by Valuation at the request of petitioner for purposes of the real property transfer gains tax. Mr. Gyetvan, the appraiser, is a member of the American Society of Real Estate Appraisers and has engaged in studies of real property valuation issues with the American Institute of Real Estate Appraisers. Mr. Gyetvan testified to the process he followed in developing the fair market value of the Rye Brook property for gains tax purposes. His conclusion was that the property had a fair market value of \$81 million as of November 2, 1985. This value was reached after an examination of the values developed under the three appraisal approaches: the cost approach; the income approach and the sales comparison approach. Mr. Gyetvan's testimony supported the results reached by the Valuation Report. The Valuation Report and the testimony of Mr. Gyetvan are sufficient to meet petitioner's burden of showing by clear and convincing evidence that the fair market value of the Rye Brook property as of November 2, 1985 was \$81 million.

The Valuation Report provides a discussion of the methods, information and supporting documentation (except the Marshall Valuation Service's cost-per-square-foot tables) used to arrive at the appraisal of the property. Although the Division makes much of the lack of the cost-per-square-foot tables, its absence does not carry the importance the Division desires. The Division contends that:

"To complete a cost analysis all that was necessary was to trend \$97,000,000 forward for two years to the date of sale and add a factor for entrepreneurial profit. From this number one would then subtract accrued depreciation and functional obsolescence."

Such a computation arrives at a figure of \$111,550,000.00 ( $97 \text{ M} \times 1.15^2$ ). This is almost the same amount that the Valuation Report arrives at in its computation of the reproduction cost new (\$110,050,000.00). The difference in the results arrived at by the Valuation Report and the

Division's method (in effect, the Leventhal Report) is the application of external and functional obsolescence. Even the Division believes that accrued depreciation and functional obsolescence should be subtracted from this number. However, the Leventhal Report reached a higher, not lower, number. Thus the more important explanation involves not the Marshall Valuation Service's cost-per-square-foot tables but why one report applied external and functional obsolescence and the other did not.

The Valuation Report explains that because the subject building was an elaborate corporate headquarters, was overbuilt in various areas, had aluminum siding which was difficult to keep clean and had insufficient restrooms in the general office area, a 10% allowance was made for functional obsolescence. The Valuation Report further explains that the size and unique nature of the subject building would make marketing difficult; the overall size of the subject limits the number of potential users; and new ownership would desire to create a new image for the property and disassociate itself from the image of General Foods. Due to the size of the property this would be a costly undertaking and a 15% allowance was provided for external obsolescence.

There is no information available in the record which indicates why allowances were not made for physical deterioration, and for functional and external obsolescence in the Leventhal Report. The Division contends that the responsibility for placing such information in the record rests entirely with petitioner, despite the reliance of the Division upon the Leventhal Report's conclusion concerning the fair market value of the property in issue. The Division claims that the paucity of documents relating to the Leventhal Report hurts petitioner's case because it leaves petitioner unable to establish any errors in such report. However, the lack of any information as to how the fair market value was arrived at leaves one unable to compare and evaluate the two reports. Therefore, the Leventhal Report is insufficient to carry the Division's burden of going forward to establish that the Valuation Report and its results were inaccurate. If the Division wanted to rely upon the information contained in the Leventhal Report to establish errors in the results of the Valuation Report, it could have exercised its subpoena

power and introduced it into the record as part of its case (Matter of Capital Dist. Better TV v. Tax Appeals Tribunal, \_\_\_ AD2d \_\_\_, 606 NYS2d 930; Matter of Avildsen, Tax Appeals Tribunal, May 19, 1994). Furthermore, the Leventhal Report fails to follow the Uniform Standards of Professional Appraisal Practice (19 NYCRR 1106). There is no explanation contained within the submitted appraisal to explain and support the exclusion of any of the usual valuation approaches (19 NYCRR 1106.2[b][3][x]). The report does not provide an explanation as to why it did not consider all physical, functional and external market factors as they might affect the appraisal (19 NYCRR 1106.2[a][5][vii]). Such a report cannot overcome the evidence introduced by petitioner to establish the fair market value of the Rye Brook property as of November 2, 1985 to be \$81 million.

D. Petitioner is not bound by the value of the subject property reported on its tax returns. The gains tax regulations specifically provide that the fair market value of property such as that at issue is, generally, determined by appraisal (20 NYCRR 590.47[b]). This was the method used by petitioner. The need for an appraisal to determine the fair market value of the property is evidenced by the Division's attempts to bolster the Leventhal Report and make it the basis of the property at issue.

E. Petitioner argues that the amount of gain should be reduced by \$14,061,766.00 paid to Goldman, Sachs & Co. and Shearson Lehman Brothers, Inc. (\$7,030,883.00 each) as brokerage commissions. Tax Law § 1440.1(a) defines "consideration" as the "price paid or required to be paid for real property or any interest therein, less any customary brokerage fees related to the transfer if paid by the transferor . . . ." Thus, under the statute, the transferor is entitled to reduce the gain by any customary brokerage fees related to the transfer.

In support of its claim that it incurred \$14,061,766.00 in brokerage fees in transferring the property, petitioner introduced two invoices. One invoice refers to a letter agreement dated September 26, 1985 between Goldman, Sachs & Co. and General Foods. The second invoice references a fee agreement of September 26, 1985 between Shearson Lehman Brothers and General Foods. Neither agreement was entered into evidence. Without the agreements it

cannot be determined what services were performed and whether any of the services constituted customary brokerage fees.

Petitioner's witness described the services which were paid for as fees for advising General Foods during the merger. The invoices represented the fees for all services rendered in the merger. He further stated that the services were to provide advice to General Foods as to whether the offer being made by petitioner was in the best interests of the General Foods shareholders. Financial consulting and financial advisory services are not brokerage fees and therefore not deductible from consideration. In addition, Goldman, Sachs & Co. and Shearson Lehman Brothers, Inc. are not licensed real estate brokers.

Even if the fees or some portion thereof were determined to be brokerage fees, since the fees represented payment for all the services performed during the merger, petitioner would first have to allocate the fees between any allowable brokerage activity and the other services performed. It would then have to allocate the fees between the value of the realty and all the other assets transferred. Petitioner would next have to allocate the fees between the value of the New York realty and the value of General Foods' non-New York holdings. None of the above allocations have been done and thus there is no way to determine what portion of the fees would be attributable to the New York realty.

Petitioner has failed to establish that brokerage services were performed, that the services at issue were performed by licensed real estate brokers and what portion of the services were attributable to the New York realty, and therefore is not entitled to the brokerage deduction.

F. At the time of the transaction, gains tax regulation section 590.49(c) provided as follows:

"(c) **Question:** What is the transferor's original purchase price when any percentage interest in an entity is resold?

"**Answer:** No matter what percentage interest was purchased, when such interest is resold, the original purchase price is the apportioned amount of the entity's original purchase price (determined without regard to a step-up in original purchase price due to an acquisition of a controlling interest), or the apportioned amount of the fair market value of the real property at the time such interest was acquired, whichever is higher.



**"Example 4:** T acquired a 40-percent interest in Corporation S, at a time when the fair market value of the real property was \$2,000,000. Corporation S's original purchase price in the property was \$1,000,000. T now sells his 40 percent to W, who has just purchased the other 60 percent. T is taxable since W acquired a controlling interest. The property is now worth \$5,000,000. Corporation S's original purchase price is still \$1,000,000. T's consideration is \$2,000,000, (40 percent x \$5,000,000), and his original purchase price is the greater of \$400,000 (40 percent x \$1,000,000) or \$800,000 (40 percent x \$2,000,000), thus T's original purchase price is \$800,000."

Amendments to section 590.49(c) were filed on October 23, 1990, effective November 7, 1990, and provided as follows:

**"(c) Question:** What is the transferor's original purchase price when any percentage interest in an entity is sold, where such sale results in either a transfer or an acquisition of a controlling interest?

**" Answer:** Where the transferor or transferors acquired an interest in an entity which has an interest in real property (see section 590.44 of this Part for further information on controlling interest) and such acquisition(s) resulted in either a transfer or an acquisition of a controlling interest in an entity with an interest in real property, such transferor or transferor's original purchase price is the higher of the following:

"(1) the entity's original purchase price (determined without regard to a step-up in a original purchase price due to a transfer or an acquisition of a controlling interest) multiplied by the percentage interest in the entity that such transferor or transferors is/are selling; or

"(2) the fair market value of the real property at the time such controlling interest was transferred or acquired multiplied by the percentage interest in the entity that such transferor or transferors is/are selling.

"In cases where a transferor or transferors acquired an interest in an entity with an interest in real property, and such acquisition(s) did not result in either the transfer or acquisition of a controlling interest in an entity with an interest in real property, such transferor's original purchase price for purposes of determining the gains tax due on a subsequent transfer of such interest in the entity is the amount determined by multiplying the entity's original purchase price (determined without regard to a step-up in original purchase price due to a transfer or an acquisition of a controlling interest) by the percentage interest in the entity that is being sold."

However, it is clear that former section 590.49(c) applies in this matter as the transfer occurred prior to the effective date, November 7, 1990, of the new regulation (see, TSB-A-90[10]-R).

The only evidence petitioner has introduced to establish a step-up in the original purchase price are the charts prepared by Mr. Looram. The combination of the charts and Mr. Looram's

testimony do not establish that which is claimed by petitioner. Petitioner claims that the charts represent that over 31 billion shares of General Foods stock were traded and that there were approximately 31 million new shareholders at the time of the tendering of General Foods' stock. However, the charts are unable to account for the sale and resale of the same shares of stock and would have to establish that none of the 31 million shares were sold more than once. The charts are insufficient to establish by clear and convincing evidence that petitioner is entitled to a step-up in original purchase price.

G. Tax Law former § 1446.2(a) provides that:

"[a]ny transferor failing to file a return or to pay any tax within the time required by this article shall be subject to a penalty . . . . If the tax commission determines that such failure or delay was due to reasonable cause and not due to willful neglect, it shall remit, abate or waive all of such penalty and such interest penalty."

Prior to the transaction at issue, petitioner contacted the Division to advise that it had accumulated a controlling interest in General Foods. The Division responded by forwarding to petitioner TSB-M-85(3)-R, which explains the Division's position with regard to penalty in the situation of an acquisition of a controlling interest, as follows:

"7. In the case of an acquisition of a controlling interest, the consideration is the fair market value of the real property interest acquired. Since it may not be possible to determine the consideration until some time after the acquisition has occurred, the Commission will consider this fact in determining if reasonable cause existed for the failure to pay the gains tax. To establish that this was the case, the taxpayer should contact the Department no later than the time at which an acquisition is known to have occurred. Although forms need not necessarily have been filed, the basic facts of the case should be disclosed to the Department."

There followed a series of letters from petitioner to the Division requesting additional time to file the necessary gains tax forms. These letters cover a period of approximately one year and do not explain the need for extensions beyond the general claim that attempts were being made to accumulate the necessary data. The Division responded by stating that any future requests for extensions were unwarranted and penalty and interest would be imposed if the gains tax forms were not filed by January 31, 1987. According to petitioner, the appraisals were to be completed by late July or early August 1987.

The Division made numerous telephone calls to petitioner for a two-year period at the end

of which it was advised that petitioner was still in the process of accumulating the required information. Finally, on August 23, 1989, the TP-580 and TP-581 questionnaires were filed by petitioner.

It is uncontested that petitioner late-filed returns and late-paid the tax due. Therefore, the question is whether the delay in filing and paying the tax may be considered reasonable.

In determining reasonable cause, all of the actions of a taxpayer are considered relevant (Matter of LT&B Realty Corp. v. New York State Tax Commn., 141 AD2d 185, 535 NYS2d 121). The review of these actions must be made in light of information available at that time (Matter of 1230 Park Assoc. v. Commr. of Taxation & Fin. of the State of New York, Tax Appeals Tribunal, July 27, 1989, confirmed 170 AD2d 842, 566 NYS2d 957, lv denied, 78 NY2d 859, 575 NYS2d 455; Matter of 61 East 86th Street Equities Group, Tax Appeals Tribunal, January 21, 1993).

Petitioner did not explain why the necessary information was continuously being accumulated, why the continued extensions were necessary, why the appraisal was to be completed in August 1987 and then went uncompleted for two years and what specifically was causing the delay in filing the gains tax returns.

Petitioner only claims in general terms that the magnitude and complexities of the stock acquisition caused the original purchase price and the fair market value to not be determined for some time after the transaction. Although petitioner claims that it kept the Division apprised of its progress, it does not explain the two-year gap where the Division unsuccessfully attempted on numerous occasions to obtain information about the filings. It is also noted that although the Division exhibited patience with petitioner pursuant to TSB-M-85(3)-R, that patience ended as of January 31, 1987 when petitioner failed to file the required returns.

Given the above-cited circumstances, petitioner has failed to establish that reasonable cause existed for its failure to timely file the TP-580 and TP-581 questionnaires and to timely pay the gains tax due. Although the Division at one point in time was willing to assess penalty as of January 31, 1987, the reasons cited for the imposition of penalty herein relate back to the

date of transfer, November 2, 1985, and therefore penalty is imposed from that date to date of payment.

H. The petition of Philip Morris Companies, Inc. is granted to the extent indicated in Conclusion of Law "C"; and is denied as indicated in Conclusions of Law "E", "F" and "G".

DATED: Troy, New York  
June 17, 1994

/s/ Thomas C. Sacca  
ADMINISTRATIVE LAW JUDGE